Supreme Court, U.S.
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No. 00-1435

In The

Supreme Court of the United States

BITE, INC., a Virginia corporation,

Petitioner,

v.

FIRST NATIONAL BANK, a California corporation,

Respondent.

On Petition For A Writ Of Certiorari To The California Court Of Appeals, Fourth Appellate District

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the California Court of Appeals correctly determined that, as between two creditors of a general contractor on a federal government contract, a lender with a perfected, first-in-time security interest in the proceeds of the government contract has a superior interest to that claimed by an unpaid subcontractor under equitable principles, and thereupon affirmed the trial court's grant of summary judgment in favor of Respondent First National Bank.

PARTIES TO THE PROCEEDING

Petitioner is BITE, INC., a Virginia corporation, and Respondent is FIRST NATIONAL BANK, a California corporation.

STATEMENT PURSUANT TO RULE 29.6

Respondent, FIRST NATIONAL BANK, a California corporation, does not have a parent corporation, nor does it have any publicly held companies that own 10% or more of its stock.

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STATEMENT OF JURISDICTION

Petitioner attempts to invoke the Court's jurisdiction under 28 U.S.C. § 1257(a). Respondent contends, *infra*, that 28 U.S.C. § 1257(a) does not provide a basis for jurisdiction.

CONSTITUTIONAL PROVISIONS, TREATIES, STATUTES, ORDINANCES, AND REGULATIONS INVOLVED

No provision of the United States Constitution or any treaty is involved in the decision below or the action as to which Petitioner seeks review. Only one federal statute is involved, 28 U.S.C. § 1257(a), and then only as a supposed basis for jurisdiction in this Court. The decision below was based primarily upon Sections 1103, 9104, 9203, 9301, 9303, 9310, and 9312 of the California Uniform Commercial Code and relevant California case law. Pursuant to Supreme Court Rule 24.1(f), those provisions are reproduced in the Appendix.

STATEMENT OF THE CASE

In 1984, Respondent First National Bank ("Bank") extended a $1.5 million line of credit to Systems Exploration, Inc. ("SEI"), a California technology contractor that was involved in several contracts with the United States Government. In exchange for the loan, SEI assigned to Bank and gave Bank security interests in its assets, including its government contracts and their proceeds.

Bank promptly filed UCC-1 financing statements perfecting its security interest.

Subsequently, the Government awarded SEI a contract (the "Prime Contract") for the construction of a software support and maintenance system for U.S. Air Force weapons systems. It is undisputed that Bank's security interest in SEI's assets extended to the Prime Contract and its proceeds.

In September 1988, SEI entered into a subcontract with BITE, INC. ("BITE") to provide services and materials in connection with the Prime Contract. The Government did not require SEI to post a payment bond (i.e., a Miller Act payment bond) to guarantee payment of SEI's subcontractors and suppliers, and SEI did not post a payment bond.

In 1992, a California corporation named SYS purchased SEI's assigned assets. The assets remained subject to Bank's perfected security interest. As part of the purchase transaction, SYS executed loan documents in favor of Bank, under which it agreed to repay SEI's existing loans from Bank.

In connection with the loan obligations, Bank agreed to perform "lock box" services for SEI and SYS. All remittances payable to SEI or SYS (or to Bank as assignee of SEI) under the assigned government contracts were made to the lock box, then deposited into a "control account" set up by Bank, and then applied against the outstanding loans when the checks cleared. Thereafter, Bank received payments from the Government under the Prime Contract and applied them to the outstanding loans.

In January 1995, Bank approved SYS's sale of its interest in SEI's assets to KRW Contracts and Financial Management, Inc. ("KRW") in exchange for KRW's assumption of SYS's obligations to Bank. The contract stated that Bank would maintain a segregated account for deposit of funds identified by SYS as subcontractor funds. After full payment of SYS's obligation to Bank, any amounts remaining in the account were to revert back to SYS for distribution.

SEI did not pay BITE approximately $115,000 on its subcontract. BITE demanded payment from Bank, but Bank refused to subordinate its security interest to BITE's claim. In April 1995, Bank transferred its security interest in SEI's assets, including the Prime Contract proceeds, to Big Canyon Investments, Inc. ("Big Canyon"). In November 1995, BITE sued SEI, SYS, and Bank, claiming nonpayment under its subcontract. In 1997, Bank was granted a summary adjudication of the only cause of action against it in that case. BITE subsequently settled the action with SEI, SYS, and Big Canyon for the sum of $40,000.

In February 1998, BITE filed the present action, claiming an equitable lien on the Prime Contract proceeds superior to Bank's security interest and alleging that Bank had unlawfully converted the proceeds by applying the same to the outstanding loans before the Big Canyon transfer. Bank moved for summary judgment on the ground that its first-in-time, perfected security interest was superior to BITE's later, unsecured, equitable claim. The trial court entered summary judgment in Bank's favor in March 1999.

BITE appealed to the California Court of Appeals, which reviewed the matter *de novo* and affirmed the trial court's decision. The Court of Appeals ruled, based entirely on relevant provisions of the California Uniform Commercial Code and predominantly California state case law, that:

> . . . Bank met its burden of proving entitlement to judgment as a matter of law, based on its perfected security interest in the Prime Contract proceeds, and BITE raised no triable issue of material fact requiring trial. BITE made no showing that Bank initiated, encouraged or even acquiesced in transactions between BITE and SEI, or that during performance of the subcontract BITE had any expectation of payment from the Prime Contract funds in Bank's possession.
>
> Further, BITE made no showing that the materials and services it provided on the IMIS project were required to preserve the collateral, or that BITE's performance of the subcontract relieved Bank from the responsibility of having others perform the work. BITE simply produced no evidence suggesting Bank was unjustly enriched by retaining the Prime Contract proceeds. Contrary to BITE's assertion, Bank's mere refusal to subordinate its security interest does not evidence fraud, misrepresentation or bad faith.

Pet'r's App. at 13a-14a (citation and footnote omitted). BITE's petition for rehearing by the Court of Appeals was

subsequently denied and, on December 13, 2000, the California Supreme Court denied BITE's petition for review.

ARGUMENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I. There Is No Basis For Jurisdiction In This Court.

Petitioner has tried to make a "federal case" out of what is and should remain a state court dispute. The matter presented for review is, as the California Court of Appeals determined, fundamentally a question of state law under the California Uniform Commercial Code as supplemented by state common law. Pet'r's App. A at 8a. Petitioner nonetheless attempts to shoehorn its appeal within this Court's certiorari jurisdiction under 28 U.S.C. § 1257(a). State law matters that do not violate or impinge upon rights or privileges granted or preserved by the United States Constitution, federal statutes, or other federal authority fall outside the scope of the Court's certiorari jurisdiction as outlined in Section 1257. Accordingly, the petition for writ of certiorari must be denied.

Section 1257(a) of Title 28 of the United States Code provides a basis for certiorari jurisdiction in the Supreme Court for "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had," where

> (i) the validity of a treaty or statute of the United States is drawn in question; or
>
> (ii) the validity of a statute of any State is drawn into question on the ground of its

being repugnant to the Constitution, treaties, or laws of the United States; or

(iii) any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

This case does not involve the validity of a United States treaty or statute. Nor has Petitioner challenged the validity of any State statute. BITE identifies only "equitable principles" as the source of its claimed priority to payment from the Prime Contract proceeds ahead of Bank and the supposed duty of the Government to pay subcontractors on government contracts before even first-in-time secured creditors like Bank. BITE's claims, without more, are insufficient to justify invoking this Court's certiorari jurisdiction under 28 U.S.C. § 1257(a). The petition for a writ of certiorari should be denied for want of jurisdiction.

II. There Is No Compelling Reason For Granting A Writ Of Certiorari.

BITE's petition should be denied because there is no compelling reason for granting certiorari in this matter. Rule 10 of the Supreme Court Rules specifies that certiorari review "is not a matter of right but of judicial discretion" and that review "will be granted only for compelling reasons." The character of the compelling reasons that the Court considers for granting certiorari review includes the following:

(a) a United States court of appeals decision either conflicts with the decision of another circuit court on an important matter, conflicts with a decision by a state court of last resort on *"an important federal question"*, or directly or indirectly departs from the accepted and usual course of judicial proceedings so as to call for an exercise of the Court's supervisory power;

(b) "a state court of last resort has decided *an important federal question* in a way that conflicts with the decision of another state court of last resort or of a United States court of appeals"; or

(c) "a state court or a United States court of appeals has decided *an important question of federal law* that has not been, but should be, settled by this Court, or has decided *an important federal question* in a way that conflicts with relevant decisions of this Court."

Sup. Ct. R. 10 (a)-(c) (emphasis added).

BITE has not identified any compelling reason for granting certiorari review of the decision below. Indeed, there is none. This case does not involve a conflict among the circuits or an appeal from the decision of a United States court of appeal. Nor does it involve a question of federal law, which is essential to justify certiorari review. In other words, BITE's appeal does not fall within the letter or the spirit of any of the "compelling reasons" described in Rule 10 for granting certiorari review, and BITE has not identified any other reason sufficient to warrant the issuance of a writ of certiorari.

III. A Supreme Court Decision Is Unnecessary As To The Question Presented Because Federal Law Is Well-Settled And Supports The Decision Below.

Even if a federal question were presented here, the Supreme Court and federal cases cited by BITE are distinguishable and, in any event, do not support its position. BITE's petition quotes extensively from the decisions but ignores their facts. In fact, well-settled federal law supports the decision of the Court of Appeals.

In dismissing BITE's arguments under the *Prairie State Bank* line of federal cases, the Court of Appeals distinguished each case based on (i) its context, because the cases involved claims brought by a surety, rather than by a subcontractor without the protection of a payment bond, and (ii) when the parties' respective security interests arose. Specifically, the court below correctly observed that in *Prairie State Bank v. United States*,[1] *Henningsen v. United States Fid. & Guar. Co.*,[2] and *Pearlman v. Reliance Ins. Co.*,[3] the surety's interest in the contract proceeds was superior to the competing interests because in each case the surety's interest arose earlier in time. Pet'r's App. at 14a-15a.

The Court of Appeals concluded that, even if the surety cases are applicable to this case, where no surety and no payment bond is involved, the correct and settled rule in the federal courts is that a surety's rights under its

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[1] 164 U.S. 227 (1896).

[2] 208 U.S. 404 (1908).

[3] 371 U.S. 132 (1962).

bond to government contract proceeds is superior to that of a lender under an assignment from the contractor only where the lender's assignment is "*taken subsequently* or without notice to the surety." Pet'r's App. at 15a (quoting *Maryland Cas. Co. v. Dulaney Lumber Co.*, 23 F.2d 378 (5th Cir. 1928) (citing *Prairie State, supra,* and *Henningsen, supra*)) (emphasis in original).

Here, it is undisputed that Bank's assignment and perfected security interest predated BITE's equitable interest by at least four years. Under the settled rule in *Maryland Casualty,* Bank's interest is superior to BITE's. The clarity and uniformity of the federal decisions on this issue make certiorari review of the instant case superfluous and unnecessary. The petition should be denied.

IV. BITE's Petition Misstates The Law At Issue.

Supreme Court Rule 15.2 requires a party opposing a petition for writ of certiorari to bring to the Court's attention any perceived misstatement of fact or law by the Petitioner "that bears on what issues properly would be before the Court if certiorari were granted." BITE's petition ignores the issue actually addressed and decided by the California Court of Appeals and disguises the true basis for the court's decision. In doing so, it misstates the law that was at issue below and would be at issue before this Court if certiorari were granted.

The issue that was addressed and decided by the California Court of Appeals was precisely this:

> [W]hich of two creditors has a superior interest in the proceeds of the debtor's contract with the

> federal government: an unpaid subcontractor, under equitable principles, or a lender with a perfected security interest under Division 9 of the California Uniform Commercial Code.

The Court of Appeals affirmed the trial court's summary judgment in favor of Bank, the secured creditor, entirely on the basis of California law.

Yet, BITE's petition does not even mention the State statute involved, the California UCC, or any of the California cases that supported the decision below. Instead, BITE refers only to the federal UCC and discusses only federal cases. The Court of Appeals distinguished, on two independent grounds, one entire line of cases relied on by BITE; BITE discusses those cases at length in its petition, but fails to address or even acknowledge the issues raised by the appellate court. BITE thus misrepresents this case as one posing a federal question and involving only federal authorities, and thereby attempts to mislead this Court into granting certiorari. Because no federal question is involved here, the petition should be denied.

CONCLUSION

The Seventh Circuit aptly characterized the plight of an unpaid subcontractor where no payment bond was provided as the party who "is left holding the bag." *Arvanis v. Noslo Engineering Consultants, Inc.*, 739 F.2d 1287, 1288 (7th Cir. 1984). The *Arvanis* court concluded that, although the result in that case was unjust, it was nevertheless the correct result where a federal contract

was permitted to proceed without payment bond protection for the subcontractors and suppliers. 739 F.2d at 1293.

It is regrettable that anybody must be left "holding the bag" in this case. That result is inevitable, however, in any case where the available proceeds from the prime contract are insufficient to satisfy the claims of all of the general contractor's creditors.[4]

That BITE will be left holding the bag in this instance does not elevate its priority among SEI's creditors nor convey to it any greater entitlement than Bank to payment from the Prime Contract proceeds. In fact, BITE's claim is inferior as a matter of law to Bank's claim. That is because – as the California Court of Appeals correctly determined – California state statutes and case law, as well as decisions of this Court and the other federal courts, unequivocally acknowledge the priority of a lender's first-in-time, perfected security interest and assignment over the subsequent, unsecured, equitable claim of an unpaid subcontractor.

It is undisputed that Bank in 1985 took due care to protect its interest in the Prime Contract proceeds by obtaining and duly perfecting a security interest in accordance with the California Uniform Commercial Code. In

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[4] It must be remembered that BITE has already accepted $40,000 from SYS and Big Canyon in partial settlement of its claim. The settlement reflects an election by BITE not to pursue SYS further and to pin all of its hopes for additional recovery on this action against Bank. In addition, it should be noted that Bank, even with the funds it did receive, still suffered a substantial loss on the loan it made.

contrast, when BITE later entered into the subcontract with SEI, it knew (or reasonably should have known) that no payment bond had been or would be posted. BITE took the job without the protection of a payment bond and thereby assumed the risk that it could be left "holding the bag" upon SEI's nonpayment or default.

Whether or not BITE's gamble was reasonable under the circumstances is irrelevant; fairness dictates that Bank should not be required to pay for the downside of BITE's business decisions. That is particularly true in view of the fact that Bank had no involvement whatsoever in the contract or relationship between BITE and SEI. BITE has produced no authority to the contrary.

For all of the foregoing reasons, Respondent First National Bank respectfully requests that the Court deny Petitioner BITE, Inc.'s petition for writ of certiorari.

Respectfully submitted,

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APPENDIX

28 U.S.C. § 1257(a)

Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court by writ of certiorari where the validity of a treaty or statute of the United States is drawn in question or where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

Cal. Unif. Com. Code § 1103

Unless displaced by the particular provisions of this code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Cal. Unif. Com. Code § 9104(c)

This division does not apply to any of the following:

* * *

(c) A lien given by statute or other rule of law for services or materials except as provided in Section 9310 on priority of such liens.

* * *

Cal. Unif. Com. Code § 9203

(1) Subject to the provisions of Section 4210 on the security interest of a collecting bank, Sections 9115 and 9116 on security interests in investment property, and Section 9113 on a security interest arising under the divisions on sales and leases, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless all of the following are applicable:

(a) The collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned.

(b) Value has been given.

(c) The debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subdivision (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds provided by Section 9306.

(4) A transaction, although subject to this division, is also subject to the Retail Installment Sales Act, Chapter 1 (commencing with Section 1801) of Title 2 of Part 4 of Division 3 of the Civil Code; the Automobile Sales Finance Act, Chapter 2b (commencing with Section 2981) of Title 14 of Part 4 of Division 3 of the Civil Code; the Industrial Loan Law, Division 7 (commencing with Section 18000) of the Financial Code; the Pawnbroker Law, Division 8 (commencing with Section 21000) of the Financial Code; the Personal Property Brokers Law, Division 9 (commencing with Section 22000) of the Financial Code; the Consumer Finance Lenders Law, Division 10 (commencing with Section 24000) of the Financial Code; the Commercial Finance Lenders Law, Division 11 (commencing with Section 26000) of the Financial Code; and the Mobilehomes-Manufactured Housing Act of 1980, Part 2 (commencing with Section 18000) of Division 13 of the Health and Safety Code, and in the case of conflict between the provisions of this division and that statute, the provisions of that statute control. Failure to comply with any applicable statute has only the effect which is specified in that statute.

Cal. Unif. Com. Code § 9301

(1) Except as otherwise provided in subdivision (2), an unperfected security interest is subordinate to the rights of all of the following:

(a) Persons entitled to priority under Section 9312.

(b) A person who becomes a lien creditor before the security interest is perfected.

(c) In the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that he or she gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected.

(d) In the case of accounts, general intangibles, and investment property, a person who is not a secured party and who is a transferee to the extent that he or she gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within 20 days after the debtor receives possession of the collateral, he or she takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in

bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. "Lien creditor" does not include a creditor who by filing a notice with the Secretary of State has acquired only an attachment or judgment lien on personal property, or both.

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he or she becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

Cal. Unif. Com. Code § 9303

(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9302, 9304, 9305 and 9306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

(2) If a security interest is originally perfected in any way permitted under this division and is subsequently perfected in some other way under this division, without an intermediate period when it was unperfected,

the security interest shall be deemed to be perfected continuously for the purposes of this division.

Cal. Unif. Com. Code § 9310

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

Cal. Unif. Com. Code § 9312

(1) The rules of priority stated in other sections of this chapter and in the following sections shall govern where applicable: Section 4210 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; Section 9103 on security interests related to other jurisdictions; Section 9114 on consignments; Section 9115 on security interests in investment property.

(3)[1] A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable

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[1] Enrolled bill contained no subdivision (2).

cash proceeds received on or before the delivery of the inventory to a buyer if all of the following occur:

(a) The purchase money security interest is perfected at the time the debtor receives possession of the inventory.

(b) The purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21-day period where the purchase money security interest is temporarily perfected without filing or possession (subdivision (5) of Section 9304).

(c) The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory.

(d) The notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set

forth in subdivisions (3) and (4)), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of subdivision (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, the taking of possession, or under Section 9115 or 9116 on investment property, the security interest has the same priority for the purposes of subdivision (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.